ICAEW
REPRESENTATION 9/22

R&D TAX RELIEFS REPORT

Issued 8 February 2022

ICAEW welcomes the opportunity to comment on the R&D tax reliefs report published by the government in November 2021, a copy of which is available from this link.

This response of 8 February 2022 has been prepared by the ICAEW Tax Faculty and the ICAEW Business Law Department.

Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 157,800 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 F +44 (0)20 7920 0547 icaew.com

KEY POINTS

1. ICAEW and its members are keen to support HMRC in raising compliance within the R&D regime and identifying incorrect claims and poor practices in the sector, together with any associated advisors. There is concern that the measures are not sufficiently targeted and could impose more costs and burdens on compliant taxpayers. Similarly, members are not confident that the proposed new rules will have a significant impact in challenging poor compliance by dubious practitioners.
2. There is particular concern around the requirement to notify in advance. Members want to understand the purpose of this measure and how the information would be used in a timely fashion by HMRC to justify the potential impact, particularly on first time claimants.
3. Members supported the principals around incentivising innovation activity within the UK ahead of overseas projects and this was not an unexpected policy objective given the current landscape. However, members are keen to ensure appropriate exceptions are put in place to protect genuine R&D activity which was required to be undertaken overseas. Members also consider that guidance is important as identifying overseas costs could be complex for some businesses. Many members have suggested that the blanket removal of relief from April 2023 would be quite severe and consider that the phasing of relief for ineligible overseas costs would be more equitable. This is because on-shoring these elements would likely involve moving the workforce internationally, and invariably this will take longer than 12-18m even where there was a keen appetite to do this.

DATA AND CLOUD COMPUTING COSTS

4. General feedback around this issue was that it was a welcome extension to the rules and recognises the direction of travel of the innovation and technology sector. No specific issues or concerns were raised by members.
5. Members have advised us that the level of billing detail provided by platforms to facilitate calculating a split of costs between qualifying and non-qualifying can vary quite considerably. For example, Amazon's AWS service does give a detailed breakdown of the costs relating to storage, serverless platform and the other services it offers whereas some other providers (such as MS Azure) give less detail. However, it is likely that some level of appropriate apportionment will be required in most cases. This should be feasible as apportionment is done with regards to other costs, where necessary. More guidance would be welcome as to how apportionment might work in practice given it will not be unusual for invoices to lack the granular detail required to separate qualifying and non-qualifying costs.
6. The inclusion of data sets is clearly a welcome move but there was concern as to how HMRC will approach the question of whether the dataset has 'lasting value'. Clearly a dataset is not truly consumable in that it will still exist in digital form after it has been used for R&D purposes, so how does a company demonstrate that it has no lasting value?

REFOCUSING THE RELIEFS TOWARDS INNOVATION IN THE UK

Overview

7. Members think that this approach was not unexpected given Brexit and the nature of other global R&D regimes which can have a similar element of territoriality. Many members welcomed the sentiment of the new rules and agreed that, wherever possible, the regime should incentivise innovation activity within the UK.
8. Some members think it would be helpful to have further clarity on the purpose of the new legislation and what types of activity this would be targeting. There is a view that this might be aimed at 'development hubs' established offshore solely for the reason of a lower cost base. While many members understand HMRC's approach here, we had consistent feedback that, on many occasions, the motivations behind establishing overseas development hubs were, in reality, a mixture of wider commercial factors as well as cost. The rules therefore require careful consideration to mitigate the effect on those companies with a legitimate offshore presence necessary to the R&D activity.
9. A typical example of this scenario might be where a UK company with a UK project has sites or clients overseas and, in order to implement and integrate the technology overseas, local resource on the ground will be imperative. It is not unusual for this type of labour to be outsourced for a variety of reasons. For example, UK employees might not have the appetite or local knowledge to spend significant time at overseas sites so using the existing UK workforce can be problematic. These types of issues are quite prevalent in manufacturing based R&D projects. We understand there is also a shortage of software developers, and it is not unusual for such labour to be sourced from all over the world.
10. Many members think that it is unreasonable to bring these rules in fully from April 2023 and some phasing of the restricted relief should be considered. This is because, from a commercial perspective, it will be very difficult for companies to bring jobs onshore within 12 – 18 months even where there is an appetite to do this.

Narrow exceptions

11. Within the R&D reliefs report, HMRC requested views around narrow exceptions to the overseas restrictions. There was unanimous feedback that some exceptions are necessary as there would be instances where it would not be feasible for businesses to onshore all their activities and it would be unfair to prejudice those companies whose UK R&D activities required some offshore presence.
12. Members felt there were potentially four areas of exception which could result in some offshore presence:

    1. Skills
    2. Geographical
    3. Environmental
    4. Regulatory

13. Numbers 2 – 3 would only apply where the company was unable to onshore it's activities. By way of example, geographical could apply where R&D activity was required to integrate the technology at an overseas site (as discussed above). Similarly environmental could apply in situations where we do not have the appropriate climate or conditions in the UK to undertake the R&D. Regulatory would apply where legislation required the R&D to be undertaken elsewhere.

14. The skills exception would apply where businesses are unable to recruit the required resource in the UK to undertake the R&D activity. Thought would need to be given as to how this exception could be met and monitored. From discussions with members, it would not be unusual for companies to view the establishment of an offshore R&D presence to be at least in part driven by a skills gap in the UK. Businesses are already raising issues such as job adverts being open for six months with no interest, highlighting their belief that they had no option but to look overseas.

15. As mentioned above, the issues involved in choosing the location of R&D activities and associated workers are usually a mix of wider commercial factors. One idea would therefore be to consider a proportionality clause. This would likely be most appropriate in exception 1 as, arguably, the company has no option to onshore activities where exceptions 2 – 4 are in point. This could operate such that where offshore R&D costs are below a certain proportion of the total cost of the R&D project, they are given relief but not where they exceed this proportionality threshold. Some members considered 20% to be an appropriate threshold so that, providing 80% of the total costs related to work performed in the UK, there would be no restriction on the offshore element. Where R&D projects span more than one period, this could be calculated by reference to the total costs in the period.

16. Another suggestion was that R&D relief could be tiered by reference to the qualifications of the workers involved. For example, where projects require a specialist PhD worker, it is likely to be much easier to evidence that the equivalent skill is not available in the UK.

17. Members did suggest there should be some flexibility to provide more general exceptions for public interest matters such as projects involving vaccination and public health initiatives.

18. Some members raised concerns around restricting relief for costs where all associated income from the R&D activity would be taxable in the UK (eg where the associated IP will be held in the UK). One option would be to not restrict the relief on overseas costs providing the IP is held in the UK. However, it was appreciated that this has potential to jeopardise the purpose of this part of the legislation in ensuring that companies are most incentivised to establish R&D operations within the UK, wherever possible. However, thought could be given to if it is worth incorporating some consideration of this point as part of any exceptions.

19. We noted the reference to the exception for costs associated with clinical trial volunteers. This is obviously welcome but we did receive feedback that this would need more thought as it is likely that there would be other overseas costs associated with the clinical trial, which on the face of it might, not be allowable. It is likely that a team of staff would be involved in managing this activity. There is typically infrastructure required overseas to facilitate clinical trial activity over and above the simple cost of the volunteers. More detailed guidance would therefore be appreciated.

20. Some members suggested that close consideration needed to be given to SMEs carrying out clinical trials as a large proportion, if not the majority of clinical trials, carried out by SME's are conducted as subcontracted R&D via a full service Contract Research Organisation. These clinical trials are extremely risky with huge regulatory complexity and are almost never handled directly by SMEs. Where a clinical trial cannot be effectively conducted in the UK, excluding it from a claim seems counterproductive, as it acts as a disincentive for companies to operate their R&D function in the UK.

21. For example, clinical trials in respect of rare diseases with a very small patient population will invariably require volunteers on a global scale. Given the small patient population, there is a relatively limited scope to recoup the development costs. Where the potential profit margins are very small, losing vital tax relief could be critical in the decision as to whether a particular project goes ahead. Public interest issues such as this need to be considered in any final legislation.

Tracking of overseas costs

22. Members have suggested that it is likely some businesses might find tracking overseas costs, especially by reference to where the work is performed, complex. Large international businesses are likely to find this more challenging than smaller businesses with limited overseas presence and a less mobile workforce.
23. For example, some projects involve 'brain or thinking time' and then 'churn time' on the ground. The geographical split between these will not always be clear or easily evidenced. Any guidance compiled needs to take account of the complexities involved for some businesses in identifying the offshore element.
24. Another example raised to illustrate the complexities is where a company might engage a large software business with some overseas employees. Clearly there could be some complexity in tracking where the work is performed, especially with remote working becoming more prevalent globally because of the pandemic.

ABUSE AND COMPLIANCE

Overview

25. Members welcomed measures to try and improve compliance within the R&D regime and tackle those advisors which seek to abuse the system. However, members are doubtful that the measures proposed will effectively tackle the dubious advisors at whom they are aimed, suggesting that more targeted compliance activity from HMRC would be necessary to have any significant impact.
26. There was therefore a concern that some measures might prejudice genuine R&D businesses without achieving any of the desired results regarding non-complaint claims. There is particular concern around the effect on first time claimants with respect to the requirement to inform HMRC in advance, which is discussed in more detail below.

Requirement to inform HMRC in advance

27. Members indicated that R&D projects, from a commercial perspective, often evolve on a real-time basis and they were not routinely planned in advance. From a practical perspective, it would not always be possible to inform HMRC in advance of the project commencing.
28. For example, members indicated that in practice new R&D projects often arose out of existing work. A new problem or challenge is typically identified in the course of a project which brings about a new R&D initiative.
29. The advance notification measure in isolation simply provides HMRC with information earlier as opposed to extra information. Many members are keen to understand what is the intended purpose and what would be done with that information? Clearly to be worthwhile and have any impact it is expected that HMRC would consider the information at an earlier stage. There is concern that there appears to be insufficient compliance resources already in respect of R&D (the length of time taken to receive repayments routinely raised here) and therefore what would HMRC realistically be able to do with the information within the extended timeframe?
30. Other jurisdictions have implemented this requirement with mixed results. For example, we understand that South Africa were flooded with a lot of provisional 'might make a claim' registrations, essentially businesses reserving their right to make a claim should they need to. The authorities were unable to manage the influx of information and process the registrations.
31. This is a lesson in how the measure, if not resourced appropriately, will constrain HMRC resources, without any upside in compliance.
32. Some members consider this initiative might even exacerbate compliance problems, by providing dubious practitioners the ability to place a deadline on clients. There would be the ability to pressure clients, and a 'ticking clock' or a 'use it or lose it' culture could result.

Potential new claimants may not have sufficient time to consider the rules in detail for fear of not registering by the deadline. The requirement to notify in advance could therefore create further 'sales' opportunities rather than encourage good compliance behaviours.

33. There was a general consensus from members that the requirement to notify in advance would not deter 'non-compliant' advisors but could prejudice genuine claims.

Other changes to improve compliance

34. The other measures to improve compliance were generally welcome. There was no objection to the requirement to make claims digitally. Similarly, the requirement to include more detailed information regarding the nature of the claim was viewed positively and many agreed this could help in identifying non-compliance without an undue compliance burden on compliant companies and their advisers.
35. Requiring that claims are signed by a senior officer of the company was generally viewed to be a positive development and should help to ensure R&D tax relief is on the Board agenda. We understand HMRC does not intend to make signatories personally liable for any errors in the claim. This was viewed to be a sensible approach as it was not uncommon for the detail of the R&D claim to be managed by the technology team outside of the senior Board, so that an officer of the company may well not have the appropriate insight into the claim to make it reasonable for them to be personally liable.
36. Some members think that requiring agents to have AML supervision may have an impact in identifying unscrupulous advisors, although we would expect that they should have such supervision in any event. Similarly, those advisors that are not registered with a suitable relevant professional body could be subject to increased compliance activity from HMRC.
37. Effectively members were suggesting the publication of a 'white list' of advisors which meet certain HMRC criteria. This should be a reasonably straightforward way for HMRC to risk assess advisors, thereby enabling its resources to be focussed where it is most needed.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).